No. 95-1181

In the Supreme Court of the United States

OCTOBER TERM, 1995

WILLIAM C. DUNN & DELTA CONSULTANTS, INC.,
PETITIONERS

v.

COMMODITY FUTURES TRADING COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION FOR THE COMMODITY FUTURES TRADING COMMISSION AND FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the "Treasury Amendment" to the Commodity Exchange Act, 7 U.S.C. 1 *et seq.*, which provides in pertinent part that "[n]othing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency * * * unless such transactions involve the sale thereof for future delivery conducted on a board of trade" (7 U.S.C. 2(ii)), prevents the Commodity Futures Trading Commission from bringing a judicial enforcement action arising from alleged fraud in the solicitation of investments in foreign currency options outside of an organized exchange.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-7a) is reported at 58 F.3d 50. The order and memorandum of the district court (Pet. App. 1b-6b) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 23, 1995. A petition for rehearing was denied on August 4, 1995 (Pet. App. 1c-2c). On December 12,

1995, Justice Ginsburg extended the time for filing a petition for a writ of certiorari to and including January 23, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

The "Treasury Amendment" to the Commodity Exchange Act (CEA), 7 U.S.C. 1 *et seq.*, provides as follows:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

7 U.S.C. 2(ii).

STATEMENT

The Commodity Futures Trading Commission (CFTC) brought suit in the United States District Court for the Southern District of New York against petitioners William C. Dunn and Delta Consultants, Inc. (as well as two additional corporate defendants), charging them with fraud in connection with commodity option transactions, in violation of the Commodity Exchange Act (CEA), 7 U.S.C. 1 *et seq.*, and associated regulations. See 7 U.S.C. 6c(b); 17 C.F.R. 32.9. The district court granted the CFTC's motion for the appointment of a temporary receiver, Pet. App. 1b-6b, and petitioners sought appellate review under 28 U.S.C. 1292(a)(2). The court of appeals affirmed the district court's order, rejecting petitioners' argument that the CFTC lacks regulatory

jurisdiction over transactions in foreign currency options that are not conducted on an organized exchange. Pet. App. 1a-7a.

1. This Court has previously described the history of commodity futures regulation. See *CFTC* v. *Schor*, 478 U.S. 833, 836-837 (1986); *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 355-367 (1982). Commodity futures originated in the needs of farmers and their customers to fix the price of agricultural products before harvest and delivery. See *Merrill Lynch*, 456 U.S. at 357-358. Those needs led to the organization of commodity futures exchanges, which provided price discovery and hedging functions for commodity producers and processors and speculative opportunities for investors. *Id.* at 359-360. See also S. Rep. No. 1131, 93d Cong., 2d Sess. 11-14 (1974).

During the 1920s, Congress began to impose limitations on trading in grain futures to prevent price manipulation and fraud. See Future Trading Act, ch. 86, 42 Stat. 187 (1921); Grain Futures Act, ch. 369, 42 Stat. 998 (1922). Congress expanded those measures through the Commodity Exchange Act of 1936, ch. 545, 49 Stat. 1491, which regulated futures trading in a variety of agricultural commodities. See *Merrill Lynch*, 456 U.S. at 360-363. As its central feature, the CEA required that all trading in futures respecting those commodities take place through government-designated exchanges ("contract markets") that were subject to specific statutory and regulatory requirements. See ch. 545, §§ 5-9, 49 Stat. 1492-1500. Congress amended the CEA in certain respects in 1968 (Act of Feb. 19, 1968, Pub. L. No. 90-258, 82 Stat. 26), but it retained the Act's basic structure. See *Merrill Lynch*, 456 U.S. at 364-365.

Six years later, Congress substantially revised the CEA through the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389. See *Merrill Lynch*, 456 U.S. at 364-367. The 1974 legislation amended the CEA in two respects that are especially pertinent to this case. First, the 1974 legislation established the CFTC as an independent agency charged with implementing and enforcing the Act. See § 101, 88 Stat. 1389. Second, that legislation substantially broadened the reach of the CEA by defining the term "commodity" to include non-agricultural products. See § 201, 88 Stat. 1395.[1]

During Congress's consideration of the 1974 amendments, the Acting General Counsel of the Department of the Treasury wrote to the Senate Committee on Agriculture and Forestry to express concern that, as a result of the proposed expanded definition of the term "commodity," financial instruments such as foreign currency futures and government securities which were then generally traded among dealers, banks and other sophisticated institutions, would become subject to unnecessary regulation by the newly-created CFTC. See S. Rep. No. 1131, *supra*, at 49-51. The Treasury Department proposed that the legislation be amended to exclude transactions in foreign currency and other specified financial instruments. *Ibid.* Congress responded by incorporating the Department's proposed statutory

[1] Congress has since amended and recodified the CEA through the Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865; the Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294; the Futures Trading Act of 1986, Pub. L. No. 99-641, 100 Stat. 3556; the Futures Trading Practices Act of 1992, Pub. L. No. 102-546, 106 Stat. 3590; and the CFTC Reauthorization Act of 1995, Pub. L. No. 104-9, 109 Stat. 154.

language (with slight modifications) into what is now Section 2(a)(1)(A)(ii) of the CEA, 7 U.S.C. 2(ii). That provision, which has since become known as the "Treasury Amendment," is the focus of the current dispute.

3. The CFTC filed a complaint in federal district court charging petitioners (as well as two additional corporate defendants) with fraud in connection with commodity option transactions, in violation of the CEA and associated CFTC regulations. See 7 U.S.C. 6c(b); 17 C.F.R. 32.9. The complaint charged Dunn and each corporation with making misrepresentations to existing and prospective customers concerning the likelihood of profit and loss associated with trading commodity options and the true status of their invested funds. The complaint also charged Dunn individually with liability for the corporations' fraud as an aider and abettor, in violation of 7 U.S.C. 13c(a), and as a controlling person, under 7 U.S.C. 13c(b). See Pet. App. 4a-5a.

The CFTC moved the district court to appoint a temporary equity receiver to locate, preserve, and control all four defendants' property for the benefit of customers. That request was based primarily upon the serious allegations of fraudulent conduct, the apparent disappearance of more than $180 million of customer funds, and the defendants' transfer from the United States to Switzerland of at least $19.5 million shortly before their fraudulent scheme unraveled. On June 23, 1994, the district court granted the request for appointment of a temporary receiver. Pet. App. 1b-4b. In a separate memorandum, the district court concluded that its jurisdiction to enter the receivership was proper under *CFTC* v. *American Bd. of*

Trade (*ABT*), 803 F.2d 1242 (2d Cir. 1986). Pet. App. 5b-6b.

4. The court of appeals affirmed the district court's appointment of a temporary receiver. Pet. App. 1a-7a. In relevant part, the court found, based upon the record developed to that date, that

> whatever their original intent, defendants became engaged in an old-fashioned "Ponzi" scheme, accompanied by exotic financial vocabulary. The weekly print-outs suggested large returns, which convinced most investors to "roll over" their funds. So long as these funds and money from new investors exceeded losses, any investor who wished to "cash out" could be paid off. The losses, however, were too great to be offset by "roll-overs" or new money, and much of the investors' money has disappeared.

Pet. App. 4a. In addition, the court found that at least some of the investors' money had been transferred to Switzerland. *Ibid.* In light of those findings, the court concluded that the CFTC's evidentiary proffer "sufficiently demonstrated that defendants deceived investors and caused investors to receive false reports" in violation of 7 U.S.C. 6c(b), and that the Commission had alleged facts sufficient to find Dunn personally liable under 7 U.S.C. 13c as an aider and abetter and a controlling person with respect to the violations at issue. Pet. App. 4a-5a.

The court of appeals then addressed the question of whether trading in off-exchange foreign currency options is excluded from the CFTC's jurisdiction by the language of the Treasury Amendment and, in particular, whether the phrase "transactions in foreign currency" contained within that Amendment

includes foreign currency options. Pet App. 5a. The court concluded that the legal question was controlled by its 1986 decision in *ABT*. In that case, the court of appeals had held that the purchase or sale of an option did not constitute a "transaction in foreign currency" until actual exercise of the option occurred, and the defendants' conduct was therefore not subject to the Treasury Amendment's exclusion. *ABT*, 803 F.2d at 1248. The court of appeals acknowledged that the *ABT* panel could have reached the same result through a different rationale by concluding that the instruments at issue in *ABT* were traded on an exchange and were therefore subject to regulation in any event, by virtue of the last clause of the Treasury Amendment. The court declined, however, to adopt that rationale, stating that "a later panel may not disregard the reasoning of a decision because an entirely different line of reasoning was available." Pet. App. 6a.[2]

ARGUMENT

The court of appeals' reasoning in this case is not consistent with that of the Fourth Circuit in *Salomon Forex, Inc.* v. *Tauber*, 8 F.3d 966 (1993), cert. denied, 114 S. Ct. 1540 (1994). That inconsistency, however, does not present a conflict that is ripe for this Court's resolution. The court of appeals' decision in this case is interlocutory, and its review

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[2] The court of appeals was not persuaded by the arguments of various banks, participating as amici curiae, that a number of potentially detrimental effects could result from a holding that off-exchange foreign currency options fall within CEA jurisdiction. The court noted the CFTC's suggestion that those effects were "to a degree deflected" by the CFTC's trade option exemption from the CEA. Pet. App. 7a.

would not resolve the current uncertainty over the scope of the Treasury Amendment and the regulatory authority that might be exercised by the CFTC. The Department of the Treasury and the CFTC have expressed contrary views on the statutory issue involved here, but they have instituted discussions that may lead to a regulatory or legislative resolution of their differences and address various aspects of the current uncertainty. In light of those considerations, review by the Court is not warranted at this time.

1. The Treasury Amendment exempts from CEA regulation "transactions in foreign currency * * * unless such transactions involve the sale thereof for future delivery conducted on a board of trade." 7 U.S.C. 2(ii). The court of appeals concluded that "the term 'transactions in foreign currency' does not include options, even those options traded off-exchange." Pet. App. 5a. The court relied on its previous decision in *ABT*, which reasoned:

> An option transaction giving the option holder the right to purchase a foreign currency by a specified date and at a specified price does not become a "transaction[] in" that currency unless and until the option is exercised.

803 F.2d at 1248.

Petitioners point out (Pet. 8-12) that the court of appeals' construction of the Treasury Amendment is in tension with that of the Fourth Circuit in *Salomon Forex*. That case involved a private suit in which a foreign currency brokerage company, Salomon Forex, sought to enforce a trading debt against a sophisticated foreign currency trader, Dr. Laszlo Tauber. The trader principally argued that the debts were unenforceable because they arose from off-exchange

futures and options transactions that violated the CEA. The district court rejected that defense, holding that the Treasury Amendment exempted those transactions from the CEA. See 795 F. Supp. 768 (E.D. Va. 1992). The court of appeals affirmed. It reasoned that the "broad and unqualified" phrase "transactions in foreign currency" reaches "*all* transactions in which foreign currencies are the subject matter, including options." 8 F.3d at 976.[3]

Although the court of appeals stated that its decision is inconsistent with that of the Fourth Circuit in *Salomon Forex* (Pet. App. 6a), the full scope of the Fourth Circuit's ruling in that case is unclear, see note 3, *supra*, and the decision below does not in any event create a fully ripened conflict warranting this Court's review. The court of appeals' decision in this case arises from the appointment of a temporary receiver in ongoing enforcement proceedings and is therefore interlocutory. See Pet. App. 1a. This Court does not normally grant certiorari to

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[3] The Fourth Circuit did note, however, that the parties before it were sophisticated traders and stated as follows:

> This case does not involve mass marketing to small investors, which would appear to require trading through an exchange, and our holding in no way implies that such marketing is exempt from the CEA. * * * The parties here agree that the transactions between Salomon Forex and Tauber were off-exchange transactions individually negotiated, and it is amply demonstrated that Tauber is a sophisticated investor. We hold only that individually-negotiated foreign currency option and futures transactions between sophisticated, large-scale foreign currency traders fall within the Treasury Amendment's exclusion from CEA coverage.

8 F.3d at 978.

review a non-final decision that may be affected by proceedings on remand. See, *e.g.*, *Brotherhood of Locomotive Firemen & Enginemen* v. *Bangor & Aroostock R.R.*, 389 U.S. 327, 328 (1967); *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916); *American Constr. Co.* v. *Jacksonville, Tampa & Key West Ry.*, 148 U.S. 372, 384 (1893); *Virginia Military Institute* v. *United States*, 508 U.S. 946 (1993) (Scalia, J., concurring in the denial of certiorari). Review of the court of appeals' interlocutory decision in this case would not likely be a productive use of this Court's resources because, as we explain below, the practical consequences of the decision are open to question.

2. Petitioners state (Pet. 12) that "[t]he lack of uniformity among the circuits places the global foreign currency markets in a state of considerable regulatory uncertainty." But in the end, the Second Circuit in this case simply adhered to its opinion of a decade ago in *ABT*. There also is reason to doubt that the fraudulent conduct alleged in this case—which the court of appeals described as an "old-fashioned Ponzi scheme, accompanied by exotic financial vocabulary" (Pet. App. 4a)—is generally of a sort that legitimate market participants would expect to be altogether immune from legal liability.

Significantly, moreover, the resolution of the issue presented here would not eliminate uncertainty over the regulatory status of off-exchange trading in foreign currency futures and options. Petitioners contend that the Treasury Amendment's reference to "transactions in foreign currency" includes transactions involving both foreign currency futures and options (see Pet. 10), but if the Court were to rule in petitioners' favor on that question, that ruling would

not definitively resolve whether the Treasury Amendment exempts such transactions from CEA regulation. The Treasury Amendment exempts "transactions in foreign currency * * * *unless such transactions involve the sale thereof for future delivery conducted on a board of trade*." 7 U.S.C. 2(ii) (emphasis added). Hence, the question would still arise whether futures and options transactions are subject to CEA regulation based on the Treasury Amendment's "board of trade" proviso.[4]

That issue is itself a source of considerable controversy. One source of uncertainty is the definition of "board of trade." The CEA defines the phrase "board of trade" as

> any exchange or association, whether incorporated or unincorporated, of persons who are engaged in the business of buying or selling any commodity or receiving the same for sale on consignment.

7 U.S.C. 1a(1). The courts have not reached a definitive view on the scope of that definition and, consequently, on the scope of the Treasury Amendment's "board of trade" proviso.[5] That issue may eventually

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[4] See, *e.g.*, C.A. Amicus Br. of Foreign Exchange Committee and the New York Clearing House Ass'n at 13-19 (urging the court of appeals to reverse the district court's judgment and remand the case for a determination of whether the transactions in this case were "conducted on a board of trade").

[5] The Ninth Circuit has suggested that the term "board of trade" may include virtually any "association of persons engaged in the business of selling commodities." See *CFTC* v. *Co Petro Mktg. Group, Inc.*, 680 F.2d 573, 581 (1982); but see *id.* at 584 (Smith, D.J., dissenting) (concluding that the term "board of trade" is limited to an "organized board of trade

warrant this Court's review, but it is not currently before the Court. Accordingly, the Court should not grant the petition for a writ of certiorari in this interlocutory case in the expectation that a decision favoring petitioner would significantly reduce the current uncertainty over the scope of the Treasury Amendment.

3. Petitioners note (Pet. 13-14) that the court of appeals' decision is inconsistent with the position that the United States articulated as amicus curiae in *Salomon Forex*. As the United States explained in that brief, which is reproduced as an appendix to the petition in this case (see Pet. App. 1d-25d), the Treasury Department has a continuing interest in the proper interpretation of the Treasury Amendment by virtue of its issuance of Treasury securities, its role in regulating government security brokers and dealers, and its interest in the foreign currency markets. *Id.* at 8d-11d. The United States filed that brief to express the Treasury Department's interpretation of the Treasury Amendment, which differs in significant respects from the position that the CFTC

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* * * such as the Chicago Board of Trade"). The Fourth Circuit's decision in *Salomon Forex* did not squarely decide that issue, but the court stated that it "would be inclined to reject" the position that the transactions in that case were conducted on a "board of trade." See 8 F.3d at 973 n.5; see also *id.* at 978. A district court has recently relied on the Fourth Circuit's *Salomon Forex* decision in construing the term "board of trade" to reach only organized exchanges, and the CFTC's appeal of that ruling is now pending before the Ninth Circuit. See *CFTC* v. *Frankwell Bullion Ltd.*, 904 F. Supp. 1072, 1075-1076 (N.D. Cal. 1995), appeal docketed, Nos. 95-16977 and 95-17298 (9th Cir.).

(which has independent litigating authority in the lower courts) put forward below.

The court of appeals' decision does not embrace the views expressed by the United States in *Salomon Forex*, and there is currently a disagreement between the Treasury Department and the CFTC over the proper interpretation of the Treasury Amendment. The Treasury Department, the CFTC, and other interested federal agencies recognize the need for discussions regarding their views on the Treasury Amendment and the possibility of further invocation by the CFTC of its authority to exempt certain matters from regulation. See 7 U.S.C. 6(c); 17 C.F.R. 32.4 and 35.2. Those discussions have begun. It is not unrealistic to anticipate that they may lead to regulatory or legislative proposals that will eliminate or narrow the source of the agencies' disagreement and will address concerns about uncertainty in foreign currency markets regarding the scope of regulatory authority that would be exercised by the CFTC.[6] In the event that those efforts do not prove fruitful, this Court will have other opportunities to review the issue presented here, either on writ of certiorari from a final judgment in this case, or on writ of certiorari from a final judgment in another case that also presents the "board of trade" issue. Accordingly, we suggest that this case does not warrant review by the Court at this time.

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[6] For example, the CFTC and the SEC previously disagreed over their respective regulatory authority concerning options on government securities. The CFTC and the SEC reached an accord and jointly sponsored legislation (Act of Oct. 13, 1982, Pub. L. No. 97-303, 96 Stat. 1409) that mooted ongoing litigation. See *Board of Trade* v. *SEC*, 677 F.2d 1137 (7th Cir.), vacated as moot, 459 U.S. 1026 (1982).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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